Supreme [illegible]

[illegible]

No. [illegible]

TRUST UNDER AGREEMENT DATED [illegible], BY JOHN E. ANDRUS, DECEASED (TRUST NO. [illegible]), CENTRAL HANOVER BANK AND TRUST COMPANY, HAMLIN F. ANDRUS, and WILLIAM [illegible], Trustees,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

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THE COURT PRESS, N. Y. C.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947.

No. .

TRUST UNDER AGREEMENT DATED DECEMBER 30, 1921 BY JOHN E. ANDRUS, DECEASED (TRUST NO. 1), CENTRAL HANOVER BANK AND TRUST COMPANY, HAMLIN F. ANDRUS, and WILLIAM H. TAYLOR, Trustees,

Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Background and Jurisdiction.

Petitioners, by J. S. Seidman, their counsel, pray that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Second Circuit, entered in the above entitled case on July 24, 1947, reversing the decision of The Tax Court of the United States.

The opinion of the Circuit Court of Appeals is reported at —— F. (2d) ——. The opinion of the Tax Court is reported at 7 T. C. 573.

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

(1) The tax statute allows a trust to deduct any part of the *gross* income, without limitation, that goes to charity. Is that deduction in any way limited by the fact that in computing *net* income (as distinguished from gross income), only part of the long term capital gains of the trust is taken into account? The Tax Court held that the charity deduction is not so limited. The Circuit Court of Appeals ruled the opposite, and as a result allowed less for the charity deduction than actually paid.

(2) Is this a case, as petitioners maintain, peculiarly within the authority of the Tax Court and a proper one in which to apply the principle laid down in *Dobson* v. *Commissioner,* 320 U. S. 489, that the Tax Court should be upheld if its decision is warranted in the record and reasonable in the law? This point was briefed and argued to the Circuit Court of Appeals by both parties. That court, in rendering its opinion, made no mention of it at all.

Applicable Provisions of Internal Revenue Code (26 U. S. C. 1940 ed.).

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes * * * gains or profits and income derived from any source whatever.

(f) *Determination of Gain or Loss.*—In the case of a sale or other disposition of property, the gain or loss shall be computed as provided in section 111.

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions: * * *

(g) *Capital Losses.*—

(1) *Limitations.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

SEC. 117. CAPITAL GAINS AND LOSSES.

(a) *Definitions.*—As used in this chapter * * *

(4) *Long-Term Capital Gain.*—The term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing *net* income; (italics supplied)

(b) *Percentage Taken Into Account.*—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing *net* income: (italics supplied)

100 per centum if the capital asset has been held for not more than 18 months;

$66\frac{2}{3}$ per centum if the capital asset has been held for more than 18 months but not for more than 24 months;

50 per centum if the capital asset has been held for more than 24 months.

SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

(a) There shall be allowed as a deduction (in lieu of the deduction for charitable, etc., contributions authorized by section 23 (o)) any part of the *gross income,* without limitation, which pursuant to the terms of the will or deed creating the trust, is during the taxable year paid or permanently set aside for the purposes and in the manner specified in Section 23 (o), or is to be used exclusively for religious, charitable, scientific, literary, or educational purposes * * *. (italics supplied)

Statement.

This is an income tax case involving the year 1941. Petitioners are trustees under a trust whereby 45% of the income, and on termination of the trust, 45% of the principal goes to a charitable organization.

In 1941, the trust had a net income of $82,000. (All figures are in round amounts for convenience.) Of this, 45%, or $37,000, went to the charitable organization. The $82,000 consisted of $85,000 of net long term capital gains, less $3,000 of expenses in excess of ordinary income.

Petitioners, in their 1941 return, deducted the $37,000 paid to the charitable organization. Respondent allowed only $18,000. His theory was that since only part of the capital gains is taken into account in computing taxable net income, the deduction for the charity should be proportionately reduced.

The Tax Court held that there was no justification in statute, reason, or precedent for the claimed restriction of the deduction. To the contrary, the Tax Court pointed out that it would do violence both to the letter of the law, and to the intended spirit of encouragement of donations by trust estates, if the deduction were to be curbed in the way the government sought.

The Circuit Court of Appeals reversed the decision of the Tax Court and ruled that only $18,000 was deductible of the $37,000 paid to the charitable organization.

Reasons for Granting the Writ.

The reasons for granting the writ may be summarized as follows:

(1) The lower courts are now in disharmony; and the decision of the Circuit Court of Appeals is a flagrantly incorrect interpretation of the law.

(2) The decision flies in the face of the holdings by the Supreme Court with regard to deductions where charity is involved.

(3) The decision flies in the face of holdings by the Supreme Court about cases that are peculiarly within the authority of the Tax Court.

(4) This case is an important one involving, as it

does, every estate and trust in which charity is a beneficiary and where capital gains are realized.

Each of these will be discussed in sequential order.

(1) The lower courts are now in disharmony; and the decision of the Circuit Court of Appeals is a flagrantly incorrect interpretation of the law.

The Tax Court and the Circuit Court of Appeals are at loggerheads. The error of the Circuit Court of Appeals is easily established. There is no limit on the deduction for charity by a trust as long as the payment is of the trust's *gross* income. Section 162(a) puts it this way: "any part of the *gross* income, *without limitation,*" that goes to charity.

The Circuit Court of Appeals, pointing to Section 117(a)(4) and (5), says that a part of a capital gain does not constitute gross income. However, Section 117 has nothing to do with *gross* income. It has to do solely with the extent to which capital gains are taken into account in computing *net* income. The very language italicized by the Circuit Court of Appeals in quoting the statutory definition of a long term capital gain shows this: "gain from the sale or exchange of a capital asset held for more than 18 months, if and to the extent such gain is taken into account in computing *net* income."

Section 22(a) defines gross income as including "gains or profits and income derived from any source whatever." Section 22(f) says the amount of the gains is controlled by Section 111. The latter section says that gains are the *entire* difference between sales price and cost.

Section 22(b) labels all the exclusions from gross

income. The adjustment for capital gains is not among the exclusions. That adjustment is set forth in another section entirely—Section 117—and is labeled as a percentage that "shall be taken into account" in computing *net* income. Nothing in Section 22 defining gross income, or anything related to Section 22 says or even intimates, that capital gains are not *wholly* part of gross income.

Congress knew how to provide for a limitation when a limitation was desired. It showed this when it came to deductions and the effect of capital losses. Section 23 enumerates the allowable deductions. Section 23(g)(1) deals with the deduction for capital losses and limits the deduction "to the extent provided in Section 117". When it came to the definition of gross income in Section 22, no such limitation was expressed by Congress. This makes it clear that no such limitation was intended.

The Tax Court was so clear on all this that it did not feel justified in reconsidering the opinion, or even having it reviewed by the full court. Motions toward this end were denied (R. 2).

The Circuit Court of Appeals decision can only be explained on the inference it must have drawn that if an income item is not part of net income, it is also not part of gross income. The tax statute is not that facile or symmetrical. It has its own peculiar structure. It provides for credits "against" net income (Section 163) and amounts not "taken into account" in computing net income (Section 117), without in any way touching deductions or gross income.

The Circuit Court of Appeals cites three cases—*Grey*, *Maloy*, and *Green*, all decided by the Tax Court. The *Grey* and *Maloy* cases are thoroughly

dealt with in the Tax Court's opinion in the present case (R. 7-9, 11). The *Grey* case involved tax-free income specifically listed as an exclusion from gross income in Section 22(b)(4). The *Maloy* case had to do with the concept of "gross income stated in the return". The *Green* case has no bearing here. It holds that capital *losses*, being deductions, do not affect the amount of *gross income*.

The Circuit Court of Appeals fell into flagrant error when it reduced the deduction for charity by eliminating from gross income an amount that has to do solely with the computation of net income. As a simple matter of corrective justice, the Supreme Court should take the case unto itself.

(2) The decision flies in the face of the holdings by the Supreme Court with regard to deductions where charity is involved.

The soundness of petitioners' position is crystal clear. But even if it were only doubtful, the benefit of the doubt would have to be resolved in favor of the deduction, because the deduction involves aid to charity. The approach is succinctly stated in *Estate of J. B. Whitehead*, 3 T. C. 48, where Section 162(a), the same one with which we are here dealing, was up for interpretation. The Tax Court said:

> "Although the petitioner has the burden of showing its right to the deductions claimed, the element of charity requires liberal construction. *Helvering* v. *Bliss*, 293 U. S. 144; *Old Colony Trust Co.* v. *Commissioner*, 301 U. S. 379; *Edwards* v. *Slocum*, 264 U. S. 61."

In the *Old Colony Trust Co.* case, the Supreme Court construed Section 162(a) as allowing deductions to the full extent of the gross income, even though the taxpayer saved, and the revenues were impaired, thereby. It held that the "language should be construed with the view of carrying out the purpose of Congress—evidently the encouragement of donations by trust estates. * * * The design was to forego some possible revenue in order to promote aid to charity."

Directional beams also come from the *Bliss* case. There too, the question was the relationship between capital gains and the deduction for contributions, this time in the case of an individual under the 1928 Act. The Court said:

> "If the meaning of the act were doubtful, we should still reach the same conclusion. The exemption of income devoted to charity and the reduction of the rate of tax on capital gains were liberalizations of the law in the taxpayer's favor, were begotten from motives of public policy, and are not to be narrowly construed."

None of these principles was observed by the Circuit Court of Appeals. Instead, it reached its conclusion by an interpretation erroneous in point of law, and narrow and illiberal from the standpoint of charities. The Circuit Court of Appeals decision, instead of aiding charities, will obviously militate against them, because of the disallowance to estates and trusts of the tax deduction.

(3) The decision flies in the face of holdings by the Supreme Court about cases that are peculiarly within the authority of the Tax Court.

This case is one peculiarly within the authority of the Tax Court, and a proper case to apply *Dobson v. Commissioner,* 320 U. S. 489, in which Mr. Justice Jackson, for a unanimous court, laid down the principle that a decision of the Tax Court should be upheld if it has "warrant in the record and a reasonable basis in the law."

Petitioners maintain that the decision of the Tax Court in this case is sound and that there is no mistake of fact, law, or anything else. But even if, on review, the appellate court could entertain a reasonable difference in legal opinion from the Tax Court, this is not the sort of case where the appellate court could substitute its interpretation for that of the Tax Court.

Brooklyn National Corporation v. *Commissioner,* 157 F. (2d) 450 (C. C. A. 2), cer. den. 67 S. Ct. 96, is directly in point. Note the comparable setting of the two cases: In the present case, the problem has to do with whether the deduction for charities is curbed by the limitation on the inclusion of capital gains in computing net income. In the *Brooklyn National* case, the problem had to do with whether the credit for dividends paid was curbed by the limitation on the deduction of capital losses in computing net income.

Here are pertinent parts from the opinion in the *Brooklyn National* case:

"As we understand it, before we may substitute

our own interpretation of a provision of the Revenue Act, not only must a naked question of law detach itself from the nexus of law and fact in the record as a whole; but we must conclude that the Tax Court has been indubitably wrong in its decision of the question which emerges: reasonable differences in legal opinion we are to resolve in its favor.

"It seems to us that the right answer * * * here is not so certain that we should be justified in following our own beliefs; and therefore, although personally we are of the same mind as before, we think that we should yield to the insistence of the Tax Court, which within these limits is really the court of last appeal.

"* * * the Supreme Court * * * made clear * * * how straitly our jurisdiction is confined. * * * by assuming jurisdiction to consider the question at all, we invaded the prerogative of the Tax Court and disregarded the finality of its orders. That finality depends, as we understand, upon the added competency which inevitably follows from concentration in a special field."

These principles were reaffirmed in *American Coast Line* v. *Commissioner,* 159 F. (2d) 665 (C. C. A. 2). The setting was different from the *Brooklyn National* case and involved a more legalistic question. The question had to do with the jurisdiction of the Tax Court on an application for excess profits tax relief under Section 722(d) of the Internal Revenue Code. This Court declared:

"Finally, so far as concerns our review of the Tax Court as distinct from its own decision as

> to its jurisdiction, the case seems to us especially proper for the application of the doctrine that, even as to matters of law unmixed with fact, we are to yield our conviction to the contrary is strong. * * * It is of course not our province to fix the distribution of judicial power; least of all are we in a position to measure the higher authority which the Tax Court's constant occupation in its special field should give to its rulings, as distinct from ours in our sprawling jurisdiction."

Of like opinion is the Sixth Circuit in *Commissioner v. Wiesler,* 161 F. (2d) 997.

In the light of the parallel issue with the *Brooklyn National* case, and the doctrine laid down in that and the *American Coast Line* and *Wiesler* cases, the decision of the Tax Court in the present appeal calls for the stamp of approval and finality.

This point was briefed and argued to the Circuit Court of Appeals by both parties, but completely ignored by that court when it rendered its opinion. There was thus a clear and unwarranted flight from the pronouncements of the Supreme Court in the *Dobson* case.

Considering that the *Brooklyn National* and *American Coast Line* cases were decided by the Second Circuit itself, the unusual situation may perhaps be explained by what took place at the oral argument of the present case before the Circuit Court of Appeals. The judges said frankly that they could not tell where things stood on the *Dobson* principle in the light of the Supreme Court's decision in *Crane v. Commissioner of Internal Revenue,* 67 S. Ct. 1047.

The judges added that they were in hopes of future clarification by the Supreme Court. The granting of the present petition may afford an opportunity to impart that clarification.

(4) This case is an important one involving, as it does, every estate and trust in which charity is a beneficiary and where capital gains are realized.

If the Circuit Court of Appeals is right, the tax status of every estate and trust that has capital gains and where amounts go to charity, may be adversely affected. The case has been the subject of comment by the leading tax services and tax letters. Several of the large trust companies, and several tax lawyers have expressed concern about the case to petitioners' counsel.

Wherefore, petitioners pray that this petition for a writ of certiorari be granted.

October, 1947.

J. S. Seidman,
Counsel for Petitioners.